ST 04-0091-GIL 06/21/2004 USE TAX

If the taxpayer has already paid taxes in another state with respect to the acquisition of tangible personal property, the taxpayer may take credit for those taxes properly due and paid. See, 86 Ill. Adm. Code 150.310(a)(3) (This is a GIL.)

June 21, 2004

Dear Xxxxx:

This letter is in response to your letter dated July 15, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

> I am representing an Illinois taxpayer who desires an opinion on the taxability of a service. Taxpayer maintains a division that is a distributor of audio and video commercials. Taxpayers' customers are either advertising agencies or companies with an internal marketing department. The advertising agency has its' own customer (the third party), whereas the company with an internal marketing department will be an end user. Taxpayer receives advertisements from customers either electronically or on physical media. In either case, the receipt from the customer is considered the 'master tape'.
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> There are various radio and television stations throughout the country that accept advertisements for broadcast (the fourth party). These stations have equipment used to accept the advertisement. Certain equipment has the technology to accept an advertisement electronically. Other equipment requires the Taxpayer to place the advertisement on a tape ('dub') before shipment to the station for its broadcast. The type of equipment at a station is based upon the level of technology the station can support.

The customer will inform Taxpayer to which station(s) an advertisement should be distributed. Based upon the equipment at the station, Taxpayer will distribute the advertisement electronically or will make a dub and overnight ship. The medium used by the Taxpayer is purely chance given the type of technology and equipment residing at the TV or radio station where the customer has directed the ads to be sent. Dubs are made and sent primarily from STATE. Taxpayer bills its' charge on the lump-sum basis. The cost of the tape used in the service is less than 10% of the charge for the service.

The dub remains in the possession of radio or television station, but the ownership will transfer to the Taxpayers customer once received by the station. The risk of loss before receipt remains with Taxpayer. After airing the ad for its' intended duration, the station normally destroys the tape. The Taxpayers customer generally does not want possession of the tape. Taxpayer does not sell tapes outside of using them in the provision of the service.

The distribution is negotiated between the Taxpayer and its customer as a service. It is termed in the industry as an advertising distribution service. If the customer enters into a contract, the language will describe that the parties are enter into a service contract. Marketing materials of the Taxpayer describe this as a service.

Question:
Is the sale of advertising distribution service using a tape (or 'dub') subject to Illinois sales and use tax when sent to radio or television stations in Illinois from STATE, regardless if our actual customer is located in Illinois?

Discussion:
We believe the service should be considered non-taxable for Illinois sales & use tax purposes. The transaction at hand can be described as a mixed transaction. A mixed transaction is when you have a service being performed that includes property being transferred to the purchaser. It is implied that the title or ownership of the transferred property goes to the recipient of the service. In mixed transactions the taxing authority typically looks at the true object test. The true object test is a subjective test to determine what it is the customer is really wanting to purchase, either a service or property. It is an all or nothing test. This test looks at the reason or purpose the buyer entered into the transaction and what it is the buyer wanted to purchase. The taxing authority needs to determine whether the buyer wanted the service or the property. If the service is determined to be what the buyer wanted, then the taxation or non-taxation of the service must be followed. If the property is determined to be what the buyer wanted, then the transaction is taxable in total. Taxing authorities also refer to the true object test as the 'real object test', 'most important factor test', 'basic purpose of the buyer test', 'crucial element test' or 'essence of the transaction test'.

For the Taxpayer, the determination is what do our customers want. In this case the customers are bargaining for a service. Taxpayer describes its ad distributions as services both in marketing materials and in contract, regardless of medium used to distribute. Customers bargain for and purchase the service without knowing if Taxpayer will deliver via an electronic or dub medium. The customer informs Taxpayer which stations the ad should be sent to. The customer does not necessarily know if the stations accept electronic or dub medium, nor does the customer specifically request or care if Taxpayer sends the ad either electronically or dub. The medium used is purely chance given the type of technology and equipment residing at the TV or radio station.

A customer placing a service order instructs Taxpayer which stations getting the ad. This instruction can coincidentally yield a 100% electronic delivery or any given % mix between electronic and dub. This is further evidence that the customer is bargaining for a service.

Illinois generally does not tax services for sales and use tax, however a Service Occupation Tax (SOT) is specifically imposed on property that is transferred incidentally as part of the service transaction. [35 ILCS § 115/3] If a serviceman's cost ratio is less than 35% property he is considered 'de minimus'. If the serviceman is not required to be registered as a retailer under Section 2a of the Retailers' Occupation Tax Act, a Use Tax liability may be incurred on the cost price of the property transferred to service customers incident to his sales of service. [86 IAC §140.108(a)] The serviceman does not need to collect any additional tax from his service customer nor is he liable for Service Occupation Tax. [ST 91-0850-PLR]

In a letter ruling, the state addressed audio tapes used to delivery commercials to radio stations. The ruling indicated that there 'can be no question the company is engaged in a service business and does not sell tangible personal property at retail.' This decision is a Illinois private letter ruling, which is not binding in all cases. However the ruling does indicate the state examines the intent of the parties when services are provided. We believe the advertising distribution using dubs should be exempt in Illinois as Taxpayer will be a serviceman who owes taxes upon purchase of the tapes transferred as incident to a service.

We anticipate your response to the taxability of this service.

The business arrangement described appears to be a service situation. This type of business is subject to potential Service Occupation Tax and/or Service Use Tax liability.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen use to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred.

If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. See 86 Ill. Adm. Code 140.109.

Toward the end of the letter, you state that transactions involving the distribution of tapes into Illinois should not be subject to Illinois tax because "Taxpayer will be a serviceman who owes taxes upon purchase of the tapes transferred as incident to a service." In part this is correct. If the taxpayer is an unregistered de minimis serviceman (fourth option described above), he will owe Use Tax on property that he transfers incident to a sale of service in Illinois. However, if the taxpayer has already paid taxes in another state with respect to acquisition of the tape, the Department's regulation at 86 Ill. Adm. Code 150.310(a)(3) allows him to take credit for any tax properly due and paid.

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote
Associate Counsel

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